JAN 7 1918
JAMES D. MAHER,
CLERK.

No. 363

Supreme Court of the United States.

BOSTON STORE OF CHICAGO,
Appellant,

vs.

AMERICAN GRAPHOPHONE COMPANY AND COLUMBIA GRAPHOPHONE COMPANY,
Appellees.

BRIEF *AMICUS CURIAE* ON BEHALF OF THOMAS A. EDISON, INC.

J. EDGAR BULL,
Amicus Curiae.

To HAMILTON MOSES, ESQ.,
JOSEPH W. MOSES, ESQ.,
WALTER BACHRACH, ESQ.,
Solicitors and of Counsel for Appellant.

ELISHA K. CAMP, ESQ.,
Solicitor and of Counsel for Appellee.

SIRS: Please take notice that I will move the Court on January 7, 1918, for leave to file the within brief *amicus curiae* on behalf of Thomas A. Edison, Inc.

J. EDGAR BULL.

Service of notice of motion and copy of within brief hereby admitted.

C. G. BURGOYNE PRINTING BUSINESS, 72-78 Spring St., New York.

Supreme Court of the United States.

BOSTON STORE OF CHICAGO,
Appellant,

vs.

AMERICAN GRAPHOPHONE COMPANY and COLUMBIA GRAPHOPHONE COMPANY,
Appellees.

As counsel for Thomas A. Edison, Inc., manufacturer of Edison phonographs, which are patented machines, distributed to dealers under price-maintenance contracts, I respectfully submit *amicus curiae*, by leave of Court, the following brief:

The following cases will be referred to by their short titles:

Harrow case: *Bement vs. National Harrow Co.*, 186 U. S., 70.

Bobbs-Merrill case: *Bobbs-Merrill Co. vs. Straus*, 210 U. S., 339.

Dr. Miles case: *Dr. Miles Medical Co. vs. Park Co.*, 220 U. S., 373.

Bathtub case: *Standard Sanitary Manufacturing Co. vs. U. S.*, 226 U. S., 20.

Sanatogen case: *Bauer vs. O'Donnell*, 229 U. S., 1.

Victor case: *Straus vs. Victor Talking Machine Co.*, 243 U. S., 490.

Motion Picture case: *Motion Picture Patents Co. vs. Universal Film Manufacturing Co.*, 243 U. S., 502.

The Law.

The following propositions, we contend, are established by the above cases:

I. Before the passage of the Sherman act, the contracts under consideration clearly would have been valid

and enforcible between the contracting parties, even if they related to unpatented articles, provided it could be shown that the restrictions were reasonable, both with respect to the public and to the parties, and that they were limited to what was fairly necessary in the circumstances of the case to the protection of the parties.

II. The Sherman act does not take away from a patentee any of the rights conferred by the patent laws, and since those rights in their very nature are monopolistic and in restraint of trade, the mere fact that contracts tend to create a monopoly and restrain trade in a patented article does not bring them within the terms of that act.

III. The exclusive rights conferred by the patent laws relate only to the manufacture, use and sale of the patented article, and do not confer on a patentee the right, by notice attached to the article, to restrict resale prices of the patented article, or to restrict the use or sale of articles not covered by the patent; but a patentee may do so by special contract.

IV. The scheme exposed in the Bathtub case was held to violate the provisions of the Sherman act, not merely because the contracts fixed resale prices, but because it was shown to be, in fact, a combination formed by competitors, for the purpose and with the effect of controlling, from purchasers to consumers, more than 85 per cent. of the entire business in enameled wares. The facts in the case at bar do not resemble in essential respects those in the Bathtub case.

V. Since the passage of the Sherman act, such contracts as those under consideration, relating, as they do, to patented articles, are valid and enforcible between the contracting parties, provided it can be shown that the restrictions are reasonable, both with respect to the public and the parties, and that they are limited to what is fairly necessary in the circumstances of the case to the protection of the parties in the enjoyment of the exclusive right to make, use and sell the patented article.

I.

Before the passage of the Sherman Act, the contracts under consideration clearly would have been valid and enforceable between the contracting parties, even if they related to unpatented articles, provided it could be shown that the restrictions were reasonable, both with respect to the public and to the parties, and that they were limited to what was fairly necessary in the circumstances of the case to the protection of the parties.

In the Dr. Miles case, which related to unpatented medicines, the Court said (220 U. S., 406):

> "With respect to contracts in restraint of trade, the earlier doctrine of the common law has been substantially modified in adaptation to modern conditions. But the public interest is still the first consideration. To sustain the restraint, it must be found to be reasonable both with respect to the public and to the parties and that it is limited to what is fairly necessary, in the circumstances of the particular case, for the protection of the covenantee. Otherwise restraints of trade are void as against public policy. As was said by this court in *Gibbs v. Baltimore Gas Co.*, 130 U. S., p. 409, 'The decision in *Mitchel v. Reynolds*, 1 P. Wms., 181; S. C., Smith's Leading Cases, 407, 7th Eng. ed.; 8th Am. ed., 756, is the foundation of the rule in relation to the invalidity of contracts in restraint of trade; but as it was made under a condition of things, and a state of society, different from those which now prevail, the rule laid down is not regarded as inflexible, and has been considerably modified. Public welfare is first considered, and if it be not involved, and the restraint upon one party is not greater than protection to the other party requires, the contract may be sustained. The question is, whether, under the particular circumstances of the case and the nature of the particular contract involved in it, the contract is, or is not, unreasonable.'"

II.

The Sherman Act does not take away from a patentee any of the rights conferred by the patent laws, and since those rights in their very nature are monopolistic and in restraint of trade, the mere fact that contracts tend to create a monopoly and restrain trade in a patented article, does not bring them within the terms of that act.

Referring to the Sherman Act the Court said in the Harrow case (186 U. S., 92):

> "It is true that it has been held by this court, that the act included any restraint of commerce, whether reasonable or unreasonable (*United States v. Trans-Missouri Freight Association*, 166 U. S., 290; *United States v. Joint Traffic Association*, 171 U. S., 505; *Addystone Pipe, &c., Company v. United States*, 175 U. S., 211). But that statute clearly does not refer to that kind of a restraint of interstate commerce which may arise from reasonable and legal conditions imposed upon the assignee or licensee of a patent by the owner thereof, restricting the terms upon which the article may be used and the price to be demanded therefor. Such a construction of the act we have no doubt was never contemplated by its framers."

This statement has been quoted with approval by this Court in the Dr. Miles case and in the Bathtub case.

Further, it said in the Harrow case (186 U. S., 93):

> "The provision in regard to the price at which the licensee would sell the article manufactured under the license was also an appropriate and reasonable condition. It tended to keep up the price of the implements manufactured and sold, but that was only recognizing the nature of the property dealt in, and providing for its value so far as possible. This the parties were legally en-

> titled to do. The owner of a patented article can, of course, charge such price as he may choose, and the owner of a patent may assign it or sell the right to manufacture and sell the article patented upon the condition that the assignee shall charge a certain amount for such article."

The exclusive rights conferred on patentees are nothing if they are not monopolies. If those rights are subdivided, as the law provides they may lawfully be, between several owners or several licensees, they inevitably result in combinations in restraint of trade in respect of the patented article ; but such monopolies and such combinations in restraint of trade are not affected by the Sherman Law so long as they are fairly designed to promote the manufacture, use and sale of the thing patented. They are exposed to the condemnation of that law only when they do not fairly contribute to that end.

This Court has not intimated in any case that the protection afforded by the patent laws is in any degree diminished by the provisions of the Sherman act.

III.

The exclusive rights conferred by the patent laws relate only to the manufacture, use and sale of the patented article, and do not confer on a patentee the right, by notice attached to the article, to restrict resale prices of the patented article, or to restrict the use or sale of articles not covered by the patent; but a patentee may do so by special contract.

The proposition that the exclusive rights conferred by the patent laws do not confer on the patentee the right, by notice attached to the article, to restrict resale prices of the patented article, or to restrict the

use or sale of articles not covered by the patent, has been squarely decided in the Miles case, the Sanatogen case, the Victor case and the Motion Picture case ; and the equivalent question under the copyright law has been decided in the Bobbs-Merrill case. In neither of those cases were the parties to the suit bound by special contract ; but in each of them the right of the patentee to impose such restrictions by special contract was recognized.

For example, in the Victor case this Court said (243 U. S., 497) :

> " The abstract of the bill which we have given, makes it plain : That whatever rights the plaintiff has against the defendants must be derived from the ' License Notice ' attached to each machine, for no contract rights existed between them, the defendants being only ' members of the unlicensed general public ; ' and that the sole act of infringement charged against the defendants is that they exceeded the terms of the license notice by obtaining machines from the plaintiff's wholesale or retail agents and by selling them at less than the price fixed by the plaintiff.
>
> " It is apparent from the foregoing statement that we are called upon to determine whether the system adopted by the plaintiff was selected as a means of securing to the owner of the patent that exclusive right to use its invention which is granted through the patent law, or whether, under color of such a purpose, it is a device unlawfully resorted to in an effort to profitably extend the scope of its patent at the expense of the general public. Is it the fact, as is claimed, that this ' License Notice ' of the plaintiff is a means or agency designed in candor and good faith to enable the plaintiff to make only that full, reasonable and exclusive use of its invention which is contemplated by the patent law or is it a disguised attempt to control the prices of its machines after they have been sold and paid for ? "

And in the Motion Picture case it said (243 U. S., 509) :

> " The extent to which the use of the patented machine may validly be restricted to specific sup-

plies or otherwise by special contract between the owner of a patent and the purchaser or licensee is a question outside the patent law and with it we are not here concerned. *Keeler v. Standard Folding Bed Co.*, 157 U. S., 659."

Again (243 U. S., 513):

"Whatever right the owner may have to control by restriction the materials to be used in operating the machine must be derived through the general law from the ownership of the property in the machine and it cannot be derived from or protected by the patent law, which allows a grant only of the right to an exclusive use of the new and useful discovery which has been made—this and nothing more."

Referring to the Button-Fastener case it said in the Motion Picture case (243 U. S., 514):

"This decision proceeds upon the argument that, since the patentee may withhold his patent altogether from public use he must logically and necessarily be permitted to impose any conditions which he chooses upon any use which he may allow of it. The defect in this thinking springs from the substituting of inference and argument for the language of the statute and from failure to distinguish between the rights which are given to the inventor by the patent law and which he may assert against all the world through an infringement proceeding and rights which he may create for himself by private contract which, however, are subject to the rules of general as distinguished from those of the patent law."

So in the Bobbs-Merrill case this Court said (210 U. S., 346):

"The learned counsel for the appellant in this case in the argument at bar disclaims relief because of any contract, and relies solely upon the copyright statutes, and the rights therein conferred."

Concluding its opinion in that case, it said (210 U. S., 350):

> "In our view the copyright statutes, while protecting the owner of the copyright in his right to multiply and sell his production, do not create the right to impose, by notice, such as is disclosed in this case, a limitation at which the book shall be sold at retail by future purchasers, with whom there is no privity of contract."

In the Harrow case the parties were bound by special contract fixing prices on patented articles, and this Court held the contract valid and binding.

IV.

The scheme exposed in the Bathtub case was held to violate the provisions of the Sherman act, not merely because the contracts fixed resale prices, but because it was shown to be, in fact, a combination formed by competitors, for the purpose and with the effect of controlling, from purchasers to consumers, more than eighty-five per cent. of the business in enameled wares. The facts in the case at bar do not resemble in essential respects those in the Bathtub case.

In the Bath-tub case the Court said (226 U. S., 39):

> "But the Government asserts subterfuge, illegal purpose liveried in legal forms to give color of right to illegal practices."

At page 47 it says:

> "In this statement certain things are prominent. Before the agreements the manufacturers of enameled ware were independent and competitive. By the agreements they were combined, subjected themselves to certain rules and regulations, among others not to sell their product to the jobbers except at a price fixed not by trade and competitive conditions, but by the decision of the committee of six of their number, and zones of sales were created. And the jobbers were brought into the combination and made its subjection complete and its purpose successful. Unless they entered the combination they could obtain no enameled ware from any manufacturer who was in the combination, and the condition of entry was not to resell to plumbers except at the prices determined by the manufacturers. The trade was, therefore, practically controlled from producer to consumer and the potency of the scheme was established by the co-operation of 85% of the manufacturers and their fidelity to it was secured not only by trade advantages but by what was practically a pecuniary penalty, not inaptly termed in the argument, 'cash bail.' The royalty for each furnace was $5.00, 80% of which was to be returned if the agreement was faithfully observed; it was to be 'forfeited as a penalty' if the agreement was violated. And for faithful observance of their engagements the jobbers, too, were entitled to rebates from their purchases. It is testified that 90% of the jobbers in number and more than 90% in purchasing power joined the combination" (pp. 47, 48).

In the case at bar the Court is not dealing with a combination either of manufacturers or of dealers. It is dealing with a situation in which there is nothing resembling a monopoly, in fact, in the manufacture of phonographs, and nothing resembling lack of actual competition in the sale of such instruments. The Court will take judicial notice of the fact that the Victor Company, the Columbia Company, and Edison, Inc., are active competitors in the field, each operating

independently under its own patents, and that there are numerous smaller manufacturers making cheaper phonographs constructed according to the specifications of the expired patents of the above-named companies. There is nothing resembling a monopoly in any branch of the phonograph business considered as a whole. That there is a monopoly in the manufacture, use and sale of any given patented phonograph is only what is conferred by the patent laws and is not *per se* a violation of the Sherman Law, or against public policy.

Public interest is not concerned with price *per se*, but only with price in relation to value. Public interest may suffer by reduction of price, if it be accompanied by a more than proportionate reduction of quality and value. The Sherman act is intended to prevent situations in which price may be advanced irrespective of value, and in that sense the words " monopoly " and " restraint of trade " are used in the act. No such situation exists in the phonograph art, because the leading manufacturers of high-grade patented phonographs (Columbia, Victor and Edison) are not only in open and fierce competition with each other, but they are in open and fierce competition with the numerous manufacturers of low-priced, unpatented phonographs.

The fixing of prices on patented articles may be entirely reasonable. As this Court said in the Harrow case (186 U. S., 93):

> " The provision in regard to the price at which the licensee would sell the article manufactured under the license was also an appropriate and reasonable condition. It tended to keep up the price of the implements manufactured and sold, but that was only recognizing the nature of the property dealt in, and providing for its value so far as possible. This the parties were legally entitled to do. The owner of a patented article can, of course, charge such price as he may choose, and the owner of a patent may assign it or sell the right to manufacture and sell the article patented upon the condition that the

assignee shall charge a certain amount for such article."

In the case at bar, the Court has before it only the contract of the Columbia Company imposing price restriction on jobbers and dealers, and the fact that many of them are outstanding. It has before it no evidence as to the purpose and effect of said contract. The purpose and effect must be assumed to be legal, unless such assumption is not consistent with any possible state of facts.

V.

Since the passage of the Sherman Act, such contracts as those under consideration, relating, as they do, to patented articles, are valid and enforcible between the contracting parties, provided it can be shown that the restrictions are reasonable, both with respect to the public and the parties, and that they are limited to what is fairly necessary in the circumstances of the case to the protection of the parties in the enjoyment of the exclusive right to make, use and sell the patented article.

This proposition follows logically from the preceding propositions.

The principle which may be fairly extracted from these decisions is, therefore, that the exclusive rights conferred by patents, so long as they are honestly used to promote the enjoyment of the exclusive right to manufacture, use and sell the thing patented, are not

in any way affected by the Sherman law; but that it is possible for patentees and licensees to use patents dishonestly as a cloak for obtaining other things than the enjoyment of the exclusive right to manufacture, use and sell the thing patented; and if in so doing they commit acts prohibited by the Sherman law, they will not escape its penalties.

Are the restrictions contained in the contracts under consideration reasonable, both with respect to the public and the parties, and are they limited to what is fairly necessary in the circumstances of the case to the protection of the parties in the enjoyment of the exclusive right to make, use and sell the patented article?

Why do manufacturers of patented phonographs restrict the price at which dealers shall sell their instruments and records? As long as the manufacturer receives from the dealer his cash price, what possible concern can he have in restricting the price at which the dealer sells them? Is it not obviously to the advantage of the manufacturer that the dealer shall sell as cheaply as he will, in view of the general rule relating to merchandise that the cheaper the price the larger will be the sales? Are not such restrictions a wanton injury inflicted by the manufacturer of a patented phonograph on the purchasing public?

We are not concerned with the question as to whether price restrictions are always, or generally, beneficial to the public. We shall only endeavor to show that as applied to patented phonographs, they are directly beneficial to the public as well as the manufacturer.

If phonographs would sell themselves, just as articles of necessity sell themselves, there would be no sense in imposing price restrictions on dealers. Such restrictions clearly would be detrimental to the manufacturer who had received his cash price. But phonographs are not articles of necessity. They are

strictly articles which people can get along without. They will not sell themselves, and the manufacturer, therefore, must build up and maintain a sales organization to dispose of, and push the sales of his instruments. The Court will take judicial notice of the fact that the cost of selling such goods is large, and must be added to the price which the ultimate purchaser pays. As an element in the ultimate price, the selling cost is as essential and as legitimate as the cost of manufacturing and the overhead charges of the business.

So the successful manufacture of high-grade phonographs must build up and maintain an efficient sales organization. Efficient salesmanship of high-grade phonographs requires something more than a shop where the goods are kept and a salesman to wait on customers who come in and ask for them. There must be persistent missionary work and advertising, not only in print, but by personal effort. There must be space in which the goods can be attractively displayed. There must be a complete line of records carried and the number runs into the thousands. There must be attractive parlors in which the customer can hear and select records. There must be persons skilled in setting up and adjusting and repairing the instruments. There must be a sympathetic supervision exercised over those that are out, to keep them in order, and to repair or readjust them when they get out of order. This is commonly called the "service" which concerns dealing in high-grade phonographs furnish their customers.

Edison is not only the father of the phonograph art, but he has within recent years spent literally hundreds of thousands of dollars in improving the tone quality of his instruments, and, as the result, he has brought them to a state of perfection where their reproduction of a song is indistinguishable from the living artist's performance when heard in direct comparison, as has been frequently demonstrated in public. The instrument which produces these results is of necessity very ac-

curately made and very nicely adjusted. Should it get out of adjustment, it then fails to give the superior musical results of which it is capable, and the purchaser or user consequently does not get the full value to which he is entitled, and the reputation of the instrument suffers accordingly.

The question which a manufacturer of patented phonographs has to decide is on what lines he is to build up his sales organization. Shall it be by establishing stores in cities and towns all over the country, and equipping them with facilities in the way of merchandise and men for pushing the sales of the machines, or shall it be by making contracts with persons already having an established business in related lines of goods, which contracts will ensure to them sufficient profit, if they are industrious and enterprising, to enable them to afford to expend the capital and labor which efficient salesmanship demands shall be done by somebody.

Manifestly, a sales organization covering the entire country built on the former plan involves the investment of exceedingly large capital and is vastly more expensive than one built on the latter plan. Since in every case the ultimate purchaser must pay the cost of selling as well as the cost of manufacturing, the former plan manifestly means that the ultimate purchaser must pay a higher price for the goods and the service which he desires.

Edison selects and educates his dealers with the object of maintaining a recurring inspection of the instruments, and a readjustment of them free of charge. He maintains a department which endeavors to obtain the names of all purchasers, and these purchasers, by circulars and correspondence, are asked to inform him if their machines are not receiving the inspection and attention which he requires his dealers to give. This department incites purchasers to complaint and criticism, in order to be sure that the Edison phonographs sold are, at all times, in perfect adjustment. He maintains a force of travelling salesmen to instruct his dealers in their duties. If a

dealer does not furnish good "service," his agreement is cancelled. Edison believes that the recommendation of pleased customers is what, more than anything else, sells his machines.

If anyone who pays the manufacturer his established price can sell the phonographs for what he pleases, it is plain that the manufacturer must resort to establishing and maintaining his own stores all over the country, if he is going to maintain his present volume of business, because it is not then to the interest of any dealer to invest capital and labor in doing missionary work and furnishing the required "service", since, if he does it, his competitors, who perform no "service" and under-sell him, will profit by it and will make money, while he will lose money. Without price restrictions rigidly maintained, the only alternative for the manufacturer is to maintain his independent sales organization and to add the additional cost to the price of the machines. With price restrictions established and maintained, the manufacturer sells to the dealers at a price which yields him a reasonable profit over manufacturing cost, and ensures to the dealer a reasonable profit for the capital and labor invested by him in selling the goods. Because the dealer is selling other lines of goods which contribute their share to his overhead expenses, he can do this much cheaper than can the manufacturer; and the public gets the benefit of the saving.

Naturally Edison and other manufacturers of patented phonographs, whose sales organizations are based on the principle of price-restriction contracts, do not allow their dealers to earn more than a fair return on the capital and labor expended in selling their instruments. These large manufacturers of patented phonographs are fierce competitors in the field, and each endeavors to increase its sales by adding desirable and exclusive (patented) improvements to its machines, and by reducing the cost to the ultimate purchaser so far as it can do so. To imagine that under these circumstances they do not make as good bargains with their dealers as is consistent with

sales efficiency, is to question their business intelligence.

It is not correct to say that when a manufacturer of patented phonographs sells an instrument to a dealer who has agreed to give the required service, he has received his "full price." His "full price" includes the essential service which the dealer is required to give.

An adequate conception of the price-fixing manufacturers' motives requires an understanding of the price-cutting dealers' motives.

In the first place, it is evident that a dealer who does not furnish the service which Edison requires of his dealers, can sell the instruments at a less price and make a greater profit than can a dealer who furnishes such service. In a community there are always those who would reap where they have not sown, and a man who reaps and sells another's grain can always sell it at less than the established price and at great profit to himself. A price-cutting dealer in phonographs is in this class. Either he gives no "service" at all to the manufacturer and the public, or he gives less than he has agreed to give, for he cannot afford to cut prices if he gives full service.

In the second place, dishonest merchants frequently underprice an article of established quality and well-known price, for the purpose of creating in the minds of their patrons the false impression that other merchandise, which is not of established quality and well-known price, is sold on the same margin of profit. This is not a theory. Such methods of merchandising are as well known to merchants and advertising men as the elementary rules of law are known to lawyers. The principle is the same as that employed by the confidence man who "salts" a mine.

If a patentee of phonographs cannot establish and maintain his sales organization on the principle of price-fixing, a patent is comparatively an empty grant, except to those who have sufficient capital to establish and maintain stores in all parts of the country; because it will practically force the patentee to sell his

nventions for what he can get to some large concern which has such facilities.

WE RESPECTFULLY SUBMIT, THEREFORE, THAT THE RESTRICTIONS CONTAINED IN THE CONTRACTS UNDER CONSIDERATION ARE REASONABLE, BOTH WITH RESPECT TO THE PUBLIC AND THE PARTIES, AND THAT THEY ARE LIMITED TO WHAT IS FAIRLY NECESSARY IN THE CIRCUMSTANCES OF THE CASE TO THE PROTECTION OF THE PARTIES IN THE EXCLUSIVE RIGHT TO MAKE, USE AND SELL PATENTED PHONOGRAPHS.

J. EDGAR BULL,
amicus curiæ,
on behalf of Thomas A. Edison, Inc.